Urquhart

Subject: US Democratic Congress Bill Reinforces Canadian Governments' Stance on Income Trusts

On March 28, 2007, Carrie Tait of the National Post broke the story on the Canadian implications of the new U.S. Tax Bill before the U.S. Congress Ways and Means Committee that will take away the tax incentive for Americans to invest in Canadian income trusts. Under the new U.S. Tax Bill, if passed, the distributions from Canadian income trusts will no longer be treated as "qualified foreign dividends" taxed at the preferential rate of 15%. Instead, these distributions will be treated as income taxed at the full personal income tax rate, where the top U.S. federal income tax rate is 35%.

The U.S. Tax Bill achieves the same policy objectives for the U.S. as the Canadian income trust tax plan achieves for Canada:

(1) Stops government revenue leakage; and,
(2) Creates tax fairness, by leveling the playing field between Canadian income trusts and American corporations, Master Limited Partnerships and REITs. It is unusual for the U.S. Government to be providing such a strong incentive for American investment in Canadian income trusts, since this is effectively a subsidy for these Canadian businesses. Canadian income trusts have had substantial access to American capital at a much lower cost of capital than their American competitors. This tax driven competitive advantage was especially evident in the oil and gas industry.

The U.S. Tax Bill has no grandfathering period, so it potentially could remove the tax advantage for Americans to own Canadian income trusts well before the 2011 date, when Canada's new income trust tax would achieve the same end. The attached March 24, 2007 New York Times article, "Foreigner Get Benefit of Tax Cut," written by David Cay Johnson, has shone light on the issue of the U.S. government giving tax benefits to foreign corporations, which erode the U.S. tax base, and give these foreign companies a competitive advantage over American companies. The targeted foreign securities are the ones where no business taxes are paid in their home countries. Canadian income trusts are caught with a likely long list of other foreign securities, such as international hybrid bonds. The government leakage for the group of affected foreign securities is likely to be substantial. On Canadian income trusts alone, Americans own an estimated US$ 34 billion of Canadian income trusts and the U.S. IRS is foregoing about US $364 million per annum by treating Canadian income trusts distributions as "qualified foreign dividends" rather than income.

The author of the New York Times article is David Cay Johnston, who won a Pulitzer Prize in 2001 for his running investigation of the U.S. tax system. David Cay Johnston's attached biography says:

"His work has resulted in shutting so many tax dodges, in pressing so many new laws and regulations and enforcement efforts that some tax policy officials now consider him, as one tax law professor put it, "the de facto chief tax enforcement officer of the United States.""

Now both Canada, after last night's Canadian Budget approval, and the U.S., if this U.S. Tax Bill is passed, will no longer be providing a tax incentive for seniors to buy Canadian income trusts, which are not suitable investments for either Canadian or American seniors. Seniors are marketed income trusts on the basis of a deceptive cash yield, that does not have prominent disclosure on the significant return of capital in this cash yield, in most cases. The distributions are often not sustainable. Already one quarter of the business income trusts have suspended or cut their distributions and seniors have suffered catastrophic capital losses in these trusts in a time of economic prosperity. There is close to $10 billion of market capital losses in 56 business income trusts, whose prices are now down more than 20% from their IPO and latest secondary offering prices during the period since Janaury 1, 2001.

The U.S. securities authorities found criminal conduct and securities offences associated with the cash yield measure used in the marketing materials for limited partnerships sold by Prudential Securities Inc. in the 1980's and early 1990's. Now American securities authorities and Canadian police authorities need to investigate the alleged criminal conduct in the marketing materials of Canadian income trusts sold to American and Canadian seniors.

The Ontario Securities Commission (OSC) cannot be involved in an investigation of the deceptive cash yields in the marketing materials for Canadian income trusts since its Chairman David Wilson, has been supervisng the approval of the income trust prospectuses containing the deceptive financial measures since November 2005, and as the former C.E.O. of Scotia Capital Markets, he has supervised the co-lead due diligence on one third of the income trust offerings and the syndicate selling activities for two thirds of these income trust offerings. There are now $5 billion of market capital losses associated with the IPO and secondary offering syndicates, where Scotia Capital Markets was a member.

David Wilson should resign immediately from his position of Co-Chair of the Federal-Provincial Justice Ministers Working Group - involving police and Crown prosecutors - whose purpose is to review ways to improve securities enforcement in Canada. In the past, RCMP IMET Superintendents have written letters, one of which is attached, saying they do not investigate public complaints about securities crime, unless the alleged crime has been referred to it by one of its participating agencies, such as the OSC or the new IDA-MRS merged SRO. **David Wilson's OSC chairman role was described by Coulter Osborne, Ontario Ethics Commissioner as follows: The Chair takes an active role in overseeing Enforcement and its major cases, both before and after the issuance of a notice of hearing. This structure has led to a malfunctioning of the Commission. Enforcement, which is one of the most important branches, operates on its own without its priorities, policies or practices being subjected to the Commissioners' advice and oversight. Enforcement has been described as a "black hole" within the Commission. Report of the Fairness Committee to the Ontario Securities Commission, March 5, 2004, Page 15-16.**

More Background Information on the Impact of the New U.S. Tax Bill:

American Owners' Impact of New Canadian Income Trusts Tax Plan

	Canadian Corporation	Canadian Income Trust - Year 2011	Canadian Income Trust - Before
Profit Pre Tax	100	100	100
Business Income Tax	-32	-32	0
Profit After Business Income Tax	68	68	100
Distribution	68	68	100
Canadian Withholding Tax @ 15%	10.2	10.2	15.0
American Federal Dividend Tax Rate *	15%	15%	15%
American Federal Personal Income Tax	10.2	10.2	15.0
Foreign Tax Credit	-10.2	-10.2	-15.0
Net American Federal Personal Income Tax	0.0	0.0	0.0
Combined Business & Federal Personal Income Tax	42.2	42.2	15.0
Profit After All Taxes	57.8	57.8	85.0
Capacity to Pay Premium		0%	47%
Marginal Impact on Unit Values - No Grandfathering			-32%
Marginal Impact on Unit Values - Four Year Grandfathering			- 27%

American Owners' Impact of New U.S. Congress Bill to Deny "Qualified Foreign Dividend" Treatment for Distributions from Canadian Income Trusts

	Canadian Corporation	Canadian Income Trust - Immediate	Canadian Income Trust - Before
Profit Pre Tax	100	100	100
Business Income Tax	-32	0	0
Profit After Business Income Tax	68	100	100
Distribution	68	100	100
Canadian Withholding Tax @ 15%	10.2	15.0	15.0
American Federal Dividend Tax Rate *	15%	35%	15%
American Federal Personal Income Tax	10.2	35.0	15.0
Foreign Tax Credit	-10.2	-15.0	-15.0
Net American Federal Personal Income Tax	0.0	20.0	0.0
Combined Business & Federal Personal Income Tax	42.2	35.0	15.0
Profit After All Taxes	57.8	65.0	85.0
Capacity to Pay Premium		12%	47%
Marginal Impact on Unit Values - No Grandfathering			-24%

Source: Diane Urquhart

The U.S. government subsidy for Americans owning Canadian income trusts is the reason, in my opinion, why Americans own over 23% of Canadian income trusts generally and at least 42% of our energy trusts. The tables above show that if the U.S. Tax Bill is passed, then the U.S. Government is responsible for a marginal negative impact of about -24% on Canadian income trust unit prices compared to the -27% for the Canadian income trust plan with the four year grandfathering period. Since the Canadian new income trust tax plan is already announced, the new Congress Bill is unlikely to do further damage to Canadian income trust unit prices. There is apt to be, however, a negative kneejerk reaction initially.

The incremental significance of this U.S. Tax Bill, if passed, is that Canadians can no longer direct their anger about reduced Canadian income trust prices towards Federal Finance Minister Flaherty and the Canadian Government. Now the anger must also be directed towards the American Government. If the Congress Bill passes, then Canadians can only reasonably credit the Canadian income trusts tax plan with the average unit price decline attributable to elimination of the tax advantage for ownership of Canadian income trusts in the tax deferred plans. (This amount is say -3% = 31% Canadian tax deferred plan ownership X -11% lower Canadian tax deferred plan capacity to pay a premium over corporations = Negative $7 billion, a far cry from the $35 billion alleged to be the damage from the Canadian Income Trusts Tax Plan in current CAITI billboard and full-page newspaper ads).

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